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CLASSIFIED INSERT TO
TESTIMONY BY DOE PRINCIPAL DEPUTY ASSISTANT SECRETARY
FOR INTERNATIONAL AFFAIRS GEORGE BRADLEY BEFORE
THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
FEBRUARY 18, 1983

The unclassified version of testimony previously provided will be used for the open hearing on February 21. The unclassified version modified with the confidential insert below will be used for Friday's testimony. Insert follows the last sentence on page 2 and replaces the current section beginning on the last line of page 2 and continuing through to the first paragraph of page 4.

Insert

In the immediate aftermath of the OPEC meeting oil companies, operating on the belief that a price cut was now unavoidable, began to pull back further, refusing to lift any more crude oil than was absolutely necessary. To cover customer demands companies accelerated drawdowns of inventories or purchased oil on spot markets where it could often be obtained for some $5-$6 per barrel below official sales prices. The ability of companies to "go elsewhere" has caused production levels in OPEC and even in some non-OPEC producers to tumble.

- Nigerian production in February is currently projected by some intelligence sources to be only about .6 MMBD as compared to 1.3 MMBD in 1982. A number of companies have reportedly completely halted liftings.

- Libya, widely known as one of the so-called "cheaters," has seen its production go from 1.8 MMBD to less than 1.0 MMBD is February because of pricing disputes with the Oasis group.

- Mexican exports may have fallen to as low as 1.2-1.3 MMBD if February from a record 1.8 MMBD in November because of lack of customers.

- OPEC crude oil production as a whole is now reportedly in the range of 16.0-16.5 MMBD or about 2.0-3.0 MMBD below last year's level of about 18.8 MMBD.

Even among countries where production and exports have not yet fallen off as drastically, pressures for prices cuts have mounted as oil companies have threatened to "walk away" to cheaper alternative supplies. In three cases, the U.S.S.R., Egypt and the United States have already produced a cut in prices of around $2 per barrel. The U.K. Goernment, which has yet to take action, is being pressured by companies to cut

prices $2-$3 per barrel. The threat of being viewed as a downward price leader, especially after Yamani's comments after the recent OPEC meeting, has probably been the main reason they have not yet done so.

The key to current speculation about a fall in prices centers around what current market conditions have done to the production levels of the Gulf producers, in particular Saudi Arabia. Having watched its production fall to 4.6-4.7 MMBD in January and perhaps to substantially lower than that in February, Saudi Arabia has, through its public statements, let it be known that it is no longer willing to be solely responsible for supporting the $34 price. This has led to the widespread belief that they would cut prices unilaterally, thus precipitating a general decline in all oil prices.

While it is the current conventional wisdom that Saudi Arabia and the other Gulf producers are on the verge of a price cut, there is good ~~reason to believe~~ that this may not in fact be the ~~case~~. There have been indications that the Saudis have been unable to decide what they should do. There still seems to be a great reluctance in Saudi Arabia to cut prices even though they appear to believe such a cut is necessary and would be beneficial in the long run. At the present, they still seem to prefer to maintain a wait-and-see attitude, watching to see how things develop.

The sources of the Saudi "dilemma" appear to be:

- Fear that any unilateral pricing decision will bring economic and/or political retaliation from the Iranians who would be directly threatened by such a cut. Saudi fears have been heightened by direct and indirect Iranian threats. At the very least the Saudis appear to want to see how the renewed fighting between Iran and Iraq evolves.

- Uncertainty about the reaction to a Saudi price cut by other producers, and the fear that such a cut could set off uncontrolled price competition for customers which could lead to a price collapse and the destruction of OPEC.

- Reluctance to be perceived as doing the bidding of the West by lowering oil prices.

- The question, even without the threat of a price collapse, as to whether the Saudis would gain much in the short run from a price reduction. In fact, there is a strong possibility that producers could be worse off in this timeframe.

These factors have, to this point, outweighed pressures for a Saudi price cut. How much longer they will continue to do so is a matter of conjecture. It must be noted that the Saudis may be gaining some from the current uncertainty in the market. On the one hand, the high rate of inventory drawdown that is occurring at the present is removing much of the inventory overhang which has depressed prices over the past year. Should this continue for a period of time, companies could lose much of their flexibility and would be forced to go back into the market to lift oil from the producers. On the other hand, the current market weakness which has been depressing Saudi production is also hurting some of those OPEC countries which have opposed Saudi Arabia. Continued exposure to these pressures could make these countries more amenable to Saudi desires.

The preferred solution for the Gulf producers still seems to be one negotiated within OPEC. Despite the open acrimony within OPEC after the January meeting, negotiations have continued between Saudi Arabia and a number of countries including Nigeria, Indonesia and even Libya. The results of these negotiations are not clear at the present time.